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PP RUEHDE RUEHDH RUEHDIR  
DE RUEHRH #1167 2511420  
ZNR UUUUU ZZH  
P 081420Z SEP 09  
FM AMEMBASSY RIYADH  
TO RUEHC/SECSTATE WASHDC PRIORITY 1529  
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY  
INFO RUEHZM/GCC COLLECTIVE

UNCLAS RIYADH 001167

SENSITIVE  
SIPDIS

DEPARTMENT FOR NEA/ARP (HARRIS/BERNDT) AND EEB/IFD/OMA

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [SA](#)

SUBJECT: SAUDI INFLATION FALLS TO 4.2 PERCENT

¶1. (U) Saudi Arabian Monetary Agency (SAMA) Governor Mohamed al-Jasser presented the annual SAMA statistical report to King Abdullah in a public ceremony on August 30. Following the presentation, Governor al-Jasser announced that Saudi inflation dropped to a two-year low of 4.2 percent in July, down from 11.1 percent in July 2008. Al Jasser said he expected inflation to continue to decline until year-end, which would help improve financial stability in the Saudi economy.

¶2. (U) Al-Jasser announced that for the sixth year in a row, 2008 witnessed continued growth in the Saudi economy. Real GDP grew 4.5 percent and the private sector grew by 4.7 percent. Fueled by record oil prices, the 2008 budget surplus reached 33 percent of GDP and the balance of payment surplus stood at 28.6 percent. Saudi Arabia's banking sector continued throughout 2008 to play a constructive role in financing economic activities, as indicated by a 17.7 percent rise in monetary supply. Credit facilities granted to the private sector increased by 27.1 percent. Al-Jasser noted that private sector GDP has maintained an average annual growth rate of 5.5 percent over the past five years. The Kingdom's oil exports rose by 23.2 percent during the same period.

¶3. (U) On the down side, Governor al-Jasser pointed out that oil prices fluctuated during the last quarter of 2008 and the first two quarters of 2009. He noted that the global economy is going through one of the worst financial crises ever seen. Although Saudi Arabia was not directly hit as a result of its conservative monetary policies, the current financial crisis has brought about a global recession that is reducing the demand for oil. He emphasized the need to diversify sources of income and reduce Saudi Arabia's dependence on oil revenues by allowing the private sector to play a bigger role in the Kingdom's economic future.

COMMENT

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¶4. (SBU) Combating inflation in the Kingdom has been one of the Saudi government's highest economic priorities in recent years, despite relatively low inflation compared to other Gulf economies. When Saudi inflation reached record levels last year, it still was barely above 10 percent, but this was enough to catch the attention of senior Saudi leaders and according to some reports lead to the sacking of the Minister of Commerce and Industry. The attention of most of our contacts has focused on rising rents for both residences and business places; however, rising food prices (although again, relatively cheap compared to neighboring countries) may have hit the average Saudi family the hardest.

¶5. (SBU) Local analysts predict inflation will remain at current levels in the months to come, thanks mainly to a fall in prices of construction materials. While inflation at 4 percent is still above the comfort zone of SAG leaders, it is much closer to the Kingdom's long-term average, and significantly below last year's crisis levels. We expect Saudi leaders will continue to monitor local inflation. They will also pay close attention to discussions about global stimulus plans at the upcoming G-20 summit in Pittsburgh for signs about a return to international growth, as well as any plans

to reduce reliance on fossil fuels.

ERDMAN